

Message Text

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ACTION EUR-12

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PASS TREASURY AND FRB

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TAGS: EFIN, IT

SUBJECT: NEW DEVELOPMENTS IN ITALIAN MONETARY POLICY

1. BANK OF ITALY OPEN MARKET OPERATIONS. PRESS OVER WEEKEND HAS REPORTED ALLEGED BANK OF ITALY (BOI) DECISION TO SIGNIFICANTLY REDUCE PURCHASES OF ORDINARY TREASURY BILLS (BOT'S) FROM COMMERCIAL BANKS. WHILE BOI IS NOT BOUND TO SUPPORT SECONDARY MARKET IN TREASURY BILLS, IT HAS, TO GREATER OR LESSER EXTENT, BEEN PRACTICE OF BOI TO PURCHASE BILLS FROM LIMITED OFFICIAL USE

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COMMERCIAL BANKS AS MEANS OF SUPPLYING NEEDED SHORT-RUN

LIQUIDITY. APPARENTLY, BANK WILL NOW MORE STRICTLY LIMIT SUCH PURCHASES. THIS WOULD HELP TO FURTHER REDUCE SOURCES OF COMMERCIAL BANKS' LIQUIDITY WHILE AT SAME TIME CLOSING OFF ONE AVENUE BY WHICH CENTRAL BANK ASSISTS IN FINANCING OF TREASURY CASH DEFICIT.

2. SHARP RISE IN SHORT-TERM INTEREST RATES. AT SAME TIME, MINISTRY OF TREASURY HAS ANNOUNCED INTENT TO AUCTION NEW BOT ISSUES OF 3,500 BILLION LIRE ON MARCH 24 TO REFINANCE 3,200 BILLION LIRE BOTS WHICH MATURE AT THAT TIME. NEW BILLS WILL BE ISSUED IN THREE SERIES, AND ARE EXPECTED TO HAVE FOLLOWING APPROXIMATE YIELDS: 1,500 BILLION LIRE IN THREE-MONTH BILLS AT 16.78 PERCENT; 1,000 IN SIX-MONTH BILLS AT 15.62 PERCENT (COMPARED TO 12.5 PERCENT YIELD ONE MONTH AGO AND 9.6 PERCENT TWO MONTHS AGO), AND 1,000 IN ONE-YEAR BILLS AT 14.94 PERCENT. IN MEANTIME, INTERBANK RATES (THREE MONTHS) HAVE MORE THAN DOUBLED FROM 7.875 PERCENT ON JANUARY 20 TO 16.25 PERCENT AS OF MARCH 16, WHILE PRESS REPORTS THAT PRIME RATES WILL GO UP AGAIN FROM RECENTLY AGREED 14 PERCENT (EFFECTIVE MARCH 1) TO 16 PERCENT.

3. BOT AUCTION MARKET BROADENED. BOT AUCTION WILL FOR FIRST TIME BE OPEN TO PURCHASE BY PRIVATE INDIVIDUALS AND PENSION FUNDS ALBEIT THROUGH THE INTERMEDIATION OF STOCKBROKERS. ACCORDING TO BOI SOURCE, THIS BROADENING OF THE MARKET IS NOT EXPECTED TO HAVE A SIGNIFICANT IMPACT AT THIS AUCTION BECAUSE OF SHORT TIME AVAILABLE FOR STOCKBROKERS TO ORGANIZE THEMSELVES BEFORE THE AUCTION. NEVERTHELESS, THIS COULD IMPROVE LIKELIHOOD OF SUCCESSFUL PLACEMENT OF THIS ISSUE WHICH MAY FACE SIGNIFICANT DIFFICULTY BECAUSE OF DESIRE OF TRADITIONAL PURCHASERS (I.E., BANKS) FOR LIQUIDITY, ESPECIALLY IN FACE OF REDUCED SECONDARY MARKET IN BOTS.

4. BANK CREDIT LINES. IT HAS ALSO BEEN REPORTED IN PRESS THAT, FOR FEAR OF IMPLEMENTATION OF NEW CREDIT STRICTURES, BORROWERS ARE DRAWING DOWN FULL VALUE OF EXISTING CREDIT LINES ALREADY CONCEDED IN THEIR FAVOR AND DEPOSITING PROCEEDS IN OTHER BANKS FOR FUTURE NEEDS. PRESS HAS ALSO REPORTED THAT SOME MAJOR BANKS HAVE INFORMED THEIR MAJOR CLIENTS THAT NO NEW CREDIT LINES WILL BE EXTENDED.

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5. COMMENT. REDUCTION IN BANK OF ITALY PURCHASES OF TREASURY BILLS IN SECONDARY MARKET WOULD INITIALLY HELP TO LIMIT DOMESTIC CREDIT EXPANSION BY FREEZING BANKS' PORTFOLIOS OF BOTS AND WOULD INSURE TREASURY THAT AMOUNT OF FINANCING FROM NON-CENTRAL BANK SOURCE. HOWEVER, THIS DECISION COULD ALSO HAVE ADVERSE EFFECT ON PRIMARY MARKET BY MAKING BOTS LESS ATTRACTIVE INVESTMENT FOR BANKS AT A TIME WHEN TREASURY WILL STILL

HAVE LARGE DEMAND FOR FUNDS BOTH TO TURN OVER OLD ISSUES AND
TO FINANCE NEW BUDGET DEFICIT. DECISION OF TREASURY MINISTRY
TO BROADEN MARKET TO PERMIT PRIVATE BUYERS AND PENSION FUNDS
IN NEW BOT AUCTION, COULD NOT ONLY HELP ASSURE SUCCESSFUL
PLACEMENT, BUT COULD HAVE SALUBRIOUS EFFECT ON FINANCIAL MAR-
KETS AND BREAK VICIOUS INFLATIONARY CIRCLE OF BOTS CIRCULATING
SOLELY WITHIN CIRCUMFERENCE OF FINANCIAL INTERMEDIARIES.
VERY SHARP INCREASE IN SHORT-TERM RATES REFLECTS GOI/BOI POLICY
DECISION TO CREATE STRONG DIS-INCENTIVE FOR CAPITAL FLIGHT.
RECENT MONETARY MEASURES, PARTICULARLY BANK RESERVE REQUIRE-
MENT INCREASE, ARE CLEARLY HAVING THEIR EFFECT. VOLPE

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